Manufacturing Development Commission
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Richmond

The Manufacturing Development Commission is continuing to carry out its charge, pursuant to House Joint Resolution 735 of the 2011 Session, to develop a plan for repatriating manufacturing jobs and evaluating possible tax incentives. The Commission's second meeting of the 2011-2012 interim also focused on the costs of compliance with wastewater treatment requirements of the Chesapeake Bay cleanup program.

Manufacturing Repatriation - Federal Developments

House Joint Resolution 735 directs the Commission, in developing the manufacturing repatriation plan, to consider the proposed Bring Jobs Back to America Act that was introduced by Representative Frank Wolf. The House of Representatives has taken no action on the bill since it was referred to the House Financial Services Committee's International Monetary Policy and Trade Subcommittee on March 23, 2011.

Two major related developments have occurred at the federal level since the Commission was briefed on the Bring Jobs Back to America Act at its May meeting. The first is the insertion by Representative Wolf of six provisions relating to manufacturing repatriation in the report of the House Appropriations' Subcommittee on Commerce, Justice, Science, and Related Agencies for the fiscal year ending September 30, 2012. These provisions:

- Provide $5 million in grants to facilitate the relocation, to economically distressed regions the U.S., of services, manufacturing, or research and development activities.
- Authorize $5 million in loan guarantees to small and medium-sized manufacturers for the use or production of innovative technologies.
- Encourage the National Institute of Standards and Technology, through the Manufacturing Extension Partnership, to focus efforts on re-shoring manufacturing, including developing a suite of tools and services that can be used to identify U.S.-based suppliers for original equipment manufacturers that have off shored production.
- Direct the Secretary of Commerce to establish a Repatriation Task Force to examine incentives and other activities needed to encourage U.S. companies to bring their manufacturing and research and development activities back to this country and examine the issue of providing tax credits to companies that repatriate their operations back to this nation.
- Direct the Secretary of Commerce to launch a job repatriation initiative that includes the development of "best practices" for states and local communities to use to grow their manufacturing base and to report on the development of an online calculator that firms may use to determine hidden costs of offshore manufacturing.
- Encourage the National Science Foundation's planned activities related to the Advanced Manufacturing Initiative.

The prospects that these six provisions will become law are good. As chairman of the Subcommittee, Representative Wolf will be at the conference with Senate and the Senate is not expected to object to the inclusion of these in the omnibus FY 2012 appropriations package.

The second major development at the federal level was the announcement on June 10, 2011, of the formation of a bipartisan partnership between Representative Wolf and Senator Mark Warner to create manufacturing and technology jobs. David Hallock, now Senator Warner's State Director, briefed members on their proposal, labeled the America Recruits Act of 2011.

One feature of the America Recruits Act, called the Inbound Investment Program, is intended to help states lure manufacturers back from overseas. Under this Program, states may compete for $100 million in grants. States that receive the grants will use the funds to offer eligible employers a $5,000 loan for every new high-value job they establish at a new facility employing at least 50 people in rural or economically distressed areas. The loans would not have to be repaid if the jobs continue for at least five years.

The America Recruits Act also:

- Requires the Secretary of Commerce to ensure that industry-approved certification assessments and standards are established and available to providers of education and training programs in manufacturing and information technology.
- Establishes the U.S. Economic Competitiveness Commission.
- Provides for the establishment of repatriation task forces.
- Requires the Secretary of Commerce to conduct a survey of corporations with overseas manufacturing or customer service facilities.
- Requires the National Academy of Sciences to develop recommendations for improving advanced manufacturing.
- Requires the U.S. International Trade Commission to submit a report quantifying the effects of distortive or discriminatory economic policies of foreign countries.

Members questioned Mr. Hallock on a variety of matters regarding the federal corporate tax rate, labor policies, balance of trade, Federal Aviation Administration funding legislation, and the raising of the federal debt ceiling. Many members asked him to take messages back to Washington, and the chairman observed that Congress would do better by creating a fertile field in which jobs could be created by the private sector rather than trying to create jobs directly.

Manufacturing Repatriation - State Efforts

The Virginia Economic Development Partnership (VEDP) provided the Commission with an overview of state efforts and strategies to have firms relocate to the Commonwealth. Paul Grossman, Director of International Trade and Investment at VEDP, distinguished foreign direct investment in the U.S., which refers to the investment by a foreign company in this country, from repatriation (also known as re-shoring, onshoring, or in-sourcing), which refers to the return of financial assets from a foreign country to the country of origin.

The level of U.S. direct investment abroad has more than doubled over the past decade from $142.6 billion in 2000 to almost $329 billion in 2010. The trend was interrupted in 2005-2006 as the result of the tax holiday on the return to this country of foreign earnings of U.S. companies. Contrary to some common perceptions, 70 percent of U.S. direct investment abroad is concentrated in high-income developed countries and, according to a Congressional Research Service report from earlier this year, such investment does not lead to fewer jobs or lower incomes overall for Americans.

Mr. Grossman observed that there is evidence of the beginning of a shift toward the repatriation of manufacturing operations to the U.S. This trend has been attributed in part to rising labor costs in China. While repatriation decisions are motivated by net profit concerns, foreign direct investment in the U.S. is more likely to be driven by firms seeking to grow U.S. market share. Such foreign investment often leads to the development of new supply chain connections. Many of the factors that drive decisions to re-shore or make new foreign investment are beyond the Commonwealth's control. Such factors include federal tax policy, the need to be present in other markets, and shipping costs.

The VEDP traditionally has focused its efforts on foreign direct investment rather than repatriation, in part because the trend toward repatriation is new. The global economy is a major factor in the Commonwealth, providing $67.8 billion in investment and 445,497 jobs. Over the past 20 years, investments by foreign firms created 159,700 jobs and $18.5 billion in investment. Virginia ranks 22nd among states in the amount of foreign direct investment and 13th in terms of employment at foreign firms in the U.S.

Sandra McNinch, General Counsel to the VEDP, mentioned several issues relating to the Commonwealth's attractiveness to foreign investment. Chief among these issues is the ability to deliver the right workforce. Measures to improve Virginia's workforce include establishing a seamless and effective delivery system, increasing funding for noncredit instruction through community colleges, and increasing support for career coaching at the high school level in order to promote manufacturing as a viable career choice.

Another area where the Commonwealth could improve its attractiveness relates to taxation. The effectiveness of tax credits and other incentive programs is being studied by the Joint Legislative Audit and Review Commission pursuant to Senate Joint Resolution 329. Ms. McNinch observed the need for balanced local tax policies that acknowledge the impact of the machinery and tools tax and the business, professional and occupational license (BPOL) tax while recognizing the need for reasonable alternative sources of local revenue. The stability of tax structures and rates remains an important factor. In response to a question by Senator Reynolds regarding the ability of firms to negotiate with localities over tax rates, the chairman observed that while localities cannot discriminate among similarly situated taxpayers, localities have the option not to levy such taxes (as noted by Virginia Beach's decision to eliminate its machinery and tools tax) and flexibility regarding the rates at which local taxes are levied.

A third area affecting Virginia's attractiveness to foreign investment is its infrastructure. Investments could leverage the Commonwealth's strategic location and expand access to strategic assets. Members were urged to support investments in prepared site development for major rural and urban projects. Ms. McNinch closed her portion of the VEDP's presentation with a video presentation lauding the effectiveness of the Commonwealth Center for Advanced Manufacturing (CCAM). CCAM brings together best-in-class manufacturers (including Rolls-Royce, Siemens, NASA, and Northrop Grumman) and the University of Virginia, Virginia Tech and Virginia State University to collaborate and improve manufacturing.

Mr. Grossman concluded the VEDP presentation with a summary of how the agency targets companies and identifies opportunities, including its supply chain strategy. He also provided an overview of the VEDP's resources and work flow. Senator Wagner invited the VEDP to attend the Commission's next meeting to present specific proposals to make Virginia more attractive to manufacturers.

Manufacturing Repatriation - Recommendations Offered for Consideration

House Joint Resolution 735 directs the Commission, in developing the manufacturing repatriation plan, "to solicit and evaluate proposals to align, reorganize, and create incentives and manufacturing-related programs to repatriate manufacturing jobs and consider possible tax incentives." Brett Vassey, president and chief executive officer of the Virginia Manufacturers Association, posited that the development of a successful plan to repatriate jobs and foreign income to the Commonwealth will necessitate adoption of the ideas posed in the VEDP’s Manufacturing Impact and Economic Diversification Plan from 2007.

Mr. Vassey urged Virginia to conduct a comprehensive risk assessment of its existing industry base (which he characterized as the most globally volatile sector in the state's economy) and dependent communities. In addition, the Commonwealth was urged to map its strengths, weaknesses, opportunities, and threats (SWOT). He cited declines in employment levels in the computer and electronics manufacturing, paper manufacturing, and chemical industry sectors. Despite these employment declines, the manufacturing sector's economic output, cost of regulatory compliance, slowing quality and volume of technically skilled workers, cost of manufacturing technology, absence of a national strategic plan to level the global costs for technology-intensive manufacturers, competition from countries that have engineered their economies to grow technology-intensive manufacturing, and state and local tax dependency on the manufacturing sector have not changed.

The development of a risk assessment and SWOT analysis could complement federal legislation to repatriate jobs and foreign income. Mr. Vassey suggested that the following ideas could be adopted as part of a repatriation plan:

- Require a state assessment, including a dynamic cost-benefit analysis, of the economic impact of any environmental regulation or energy regulation on the manufacturing sector prior to enactment of legislation or regulation.
- Reduce the cost of environmental permitting, particularly in cases where pollution is reduced.
- Reform the corporate income tax apportionment elective for manufacturers by, among other things, eliminating the three-year minimum employment threshold and penalties

from the provision that allows manufacturers to elect to apportion their income among states based solely on the sales factor.

- Reform the machinery and tools tax so that manufacturers are not penalized by local government for investing in their facilities. Possible reforms include deferring the tax on new investments and providing some relief with respect to older equipment.
- Reform the federal and state workforce training programs to prioritize work readiness as a state commitment to employers.
- Utilize the Career Readiness Certificate of the VCCS and ACT WorkKeys as a credential in K-12 along with the Work Readiness Curriculum developed by the University of Virginia to insure that 100 percent of Virginians being served by government education and workforce training are certified Work Ready.
- Decentralize locations for the delivery of state services in order that manufacturers do not need to rely on centralized services in Richmond, with connections to federal and local resources, in order to provide "one stop shopping" for economic development assistance. An option is providing community-based and coordinated services through Small Business Development Centers.
- Continue to focus on freight-based infrastructure, including technology to improve travel times in congested areas and weigh-in-motion technology.
- Continue to support the Port of Virginia.
- Renew the emphasis on supporting aerospace, including projects at Wallops Island and NASA Langley, and international freight-capable airports in Virginia.

In closing, Mr. Vassey noted that there are hundreds of solid proposals that the legislature and Congress could pursue in order to reduce the cost of domestic manufacturing, improve the productivity of domestic manufacturing, and create incentives that make Virginia the premiere location for U.S. technology-intensive manufacturing. The federal government should formulate a national strategy, and the Commonwealth should implement "game changing" policies to be part of the next global manufacturing renaissance. In closing, he asserted that developing a comprehensive and coordinated repatriation program is well worth the effort.

Mark George of MeadWestvaco Corporation appeared in response to the Commission's solicitation for proposals to encourage the repatriation of manufacturing to Virginia. He noted that manufacturers move operations offshore primarily because of regulatory and tax policies. While the costs and quality of labor are frequently cited as the primary reason for offshoring manufacturing, he disputed this assertion. His suggestions for steps to encourage the repatriation of manufacturing focused on taxation, energy, and workforce development.

Recommendations related to tax policy included:

- Exempt new investments from the local machinery and tools tax.
- Reduce other state taxes to offset local machinery and tools taxes paid, such as Michigan's refundable credit of 35 percent of property taxes paid by manufacturers against the state income tax.
- Exempt assets that are more than 20 years old from machinery and tools taxation.

- Improve the definition of exempt machinery and equipment in the sales and use tax law, using the changes similar to those adopted for the semiconductor industry, because state auditors applying the existing law make it difficult to actually obtain the exemption.
- Improve audit policy by disregarding an error if the purchaser paid a self-assessed tax on the item underlying the error, because the current state policy of leaving in the item results in the state effectively collecting tax a second time from the taxpayer.
- Decrease the corporate income tax rate from six percent to five percent.
- Allow for easier changes between the three methods (consolidation, combination or separate filing) of corporate income taxation.
- Allow the single sales factor election to be fully used in 2010 instead of transitioning through 2014, as is provided for manufacturers in Georgia and South Carolina.
- Allow a 100 percent deduction of the federal domestic production activity deduction (currently the state allows a deduction of two-thirds of the federal amount).
- Oppose proposals to replace the state corporate income tax with a gross receipts tax.
- Make tax credits usable to all businesses by making them refundable and allowing offsets against other taxes such as payroll withholding.
- Enact or broaden investment tax credits and research and development tax credits.
- Drop the requirements of the tax credit for firms locating their headquarters in Virginia relating to job creation, because the documentation and certification requirements are burdensome.
- Expand environmental tax credits by including more incentives for green energy, sustainability, and energy efficiency.
- Provide that a portion of increases in revenues above a certain amount be used for targeted tax credits to increase or retain businesses in Virginia.
- Establish an independent forum for settling tax disputes, in order to allow taxpayers to have them heard in a court that is trained in handling tax cases, using the American Bar Association's model statute.
- Remove the requirement (which allegedly is not enforced) that a bond to be filed before an appeal can be filed in a tax case.
- Eliminate unemployment taxes on new hires, for increased employment, for hiring unemployed workers, and for firms relocating to the state.
- Eliminate the BPOL tax or broaden the definition of manufacturing to exempt store fronts at the place of manufacture.

Recommendations regarding energy policy, directed at ensuring that Virginia's energy rates remain affordable and produce reliable energy, included:

- Institute a requirement to produce an economic rate impact report on all proposed legislative mandates on energy producers and providers prior to legislative voting on such measures.
- Do not pit utilities against private sector companies in competition for fuel materials through a renewable portfolio standard mandate.
- Encourage combined heat and power projects for high energy users, which may include local tax exemptions such as are provided to producers of electricity from landfill gas.

Recommendations regarding workforce development focused on science, technology, engineering, and mathematics (STEM) programs. Mr. George noted that the education system pushes many students into college though most do not finish. State programs should copy Florida's program that focuses on STEM in the K-12 curriculum. Priority should be given to talent development, retention, and management. He lauded programs supporting private companies that partner with technical schools, universities, and community colleges.

Chesapeake Bay Cleanup Costs

Manufacturers have expressed concerns that new U.S. Environmental Protection Agency (EPA) regulations implemented to reduce nutrient and sediment loads in the Chesapeake Bay will result in higher wastewater treatment costs. David Paylor, Director of the Department of Environmental Quality, provided the Commission with an overview of the EPA's Bay Program, which requires states to develop a watershed improvement plan (WIP). In December 2010 the EPA issued a total maximum daily load (TMDL) finding that is intended to cap the amount of nutrients and sediments entering the Bay's watershed.

To meet the TMDL requirements, Virginia's WIP includes waste load allocations for wastewater treatment facilities and upgrades to treatment plants in the James River basin to meet dissolved oxygen and chlorophyll standards. The nutrient caps for this basin are much lower than what Virginia had expected when the EPA approved the chlorophyll standard in 2005. Upgrading wastewater systems in the James River basin to meet these limits is expected to add between $1 and $2 billion to nutrient reduction costs for wastewater treatment.

Mr. Paylor observed that the amount of grant commitments for municipal wastewater facilities under the Water Quality Improvement Fund, based on signed agreements, exceeds the available balance of bonding authority by $103 million. The potential shortfall grows to $304.3 million if projects in the application pipeline are included.

The cost of meeting the TMDL in Virginia for all sectors, including agriculture, municipal, stormwater, and industrial, has been estimated at $7 billion. Governors of states in the Bay region have asked the EPA to work with the states in developing watershed-wide cost estimates for the TMDL. Mr. Paylor closed by reporting that the EPA has said that it will conduct a study of the issue.

Christopher Pomeroy, representing the Virginia Association of Municipal Wastewater Authorities (VAMWA), provided members with information on wastewater rate trends and the impact of the TMDL. In Virginia, average monthly residential wastewater rates have increased from $18.63 in 2001 to $31.03 in 2010. Virginia's wastewater utilities have already invested between $1.5 and $2 billion in Chesapeake Bay upgrades, and utilities have reported significant rate increases to construct, operate, and maintain these facilities.

Mr. Pomeroy noted that the Water Quality Improvement Fund has helped maintain lower, more competitive sewer rates. Shortfalls in the Fund cause wastewater system owners to incur more debt, and the costs of servicing the debt is passed on to users. With regard to the costs of complying with the TMDL, he reported that the EPA unilaterally changed its computer model and reduced the 2005 nutrient limits, which had previously been approved for meeting the 2005 site-specific James River chlorophyll standard. VAMWA has been advised that the public would not get a tangible water quality benefit for the additional expenditures required to meet the new standards, which were cited as an example of the law of diminishing returns.

Members were asked to consider two cost control measures emerging in other states. First, several states prohibit state water quality regulations that are more stringent than federal requirements. Virginia law currently permits more stringent regulations if the State Water Control Board discloses that fact and explains the need for the more stringent regulation to relevant committees of the General Assembly. Second, Kentucky, Ohio, and Missouri require state agencies to evaluate the affordability and economic impact on users when issuing regulations or permits. The chairman expressed an interest in pursuing the "no more stringent than federal" provision.

Conclusion

Senator Wagner indicated that next meeting may include more information on the Commonwealth Center for Advanced Manufacturing and proposals for legislative and budgetary actions that the VEDP would like to see promoted. It is also anticipated that the Virginia Manufacturers Association will present a proposal for a legislative agenda. The chairman noted that the Commission may meet in advance of the early December deadline for submitting prefiling-eligible bill draft requests, in order that it may act on proposed legislative elements of a manufacturing repatriation plan.

Copies of presentation materials are available on the Commission's website at http://dls.virginia.gov/groups/manufacturing/meetings/080411/materials.htm.